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CONDITIONS FOR THE BANKRUPTCY OF NATURAL PERSONS: WHICH BALTIC STATE IS THE MOST ATTRACTIVE FOR BANKRUPTCY?

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Abstract. In recent years, lawmakers have struggled with a multitude of negative effects caused by the rapidly rising tide of debt distress among natural persons. Data from 2020 confirm the relevance of the bankruptcy of natural persons in the Baltic states. One of the factors that determine the choice of a natural person to go bankrupt is the provision of reasonable grounds to open bankruptcy proceedings. This article uses comparative analysis to answer, from the perspective of the debtor, the question of: in which Baltic state does the most favourable regime for initiating a bankruptcy case exist for a natural person?

Keywords: natural person, individual, Baltic state, conditions of bankruptcy, indebtedness

Introduction

There are many natural persons who can no longer meet their debt obligations in the Baltic states. For them, over-indebtedness is not just a temporary problem – various factors have led to an increase in the number of insolvent

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natural persons. As shown by economic examples, the insolvency[5] of natural persons is caused by excessive borrowing for consumption, housing, investment, private business needs, farming, taxes, and inflation, as well as the development of the credit market which stimulates consumption. On the one hand, the number of borrowers is decreasing due to the improvement of the payment administration system and the strengthening of payment discipline. On the other hand, however, the rapid growth of lending and borrowing for both consumption and business inevitably increases the number of borrowers. In economic terms, this is to be welcomed, since the development of the credit supply serves as a stimulus to the economy, even when the overall economic situation is favourable. From a social perspective, the insolvency of a natural person is typically caused by unforeseen life events such as: loss of employment, sometimes due to health problems; family changes such as marriage/divorce or the birth of children; excess credit beyond appropriate expenditure incurred by socially vulnerable persons such as seniors, single parents, or students; or start-ups who have overestimated their financial capabilities. Reasons for insolvency can also stem from personal attitudes, such as: "buy first, then pay"; an inability to accept responsibility for personal financial problems; or a lack of understanding of the essence of financial services. No research has ever conclusively established the extent to which the actions of such debtors are due to a lack of financial education or reckless spending/wilful extravagance.

Traditionally, there are two different legal models for the bankruptcy of a natural person: the Anglo-American model, which is known as the "fresh start"; and the continental European model, referred to as the "earned fresh start". The former model is, in general, more favourable for the debtor, whereas the latter emphasises the need to meet the interests of creditors. Moreover, the continental European model can, in turn, be divided into three main models: the Nordic model, which emphasises the good faith of the debtor; the German-Austrian model, which emphasises the fulfilment of the payment plan; and the French model, which rather provides for preventive measures and prescribes somewhat harsh conditions for release from debt. As can be seen from the objectives of bankruptcy proceedings and the case law discussed below, the bankruptcy law of the Baltic countries has aspects of both the Nordic and German models (Ambrasaitė & Norkus, 2014, pp. 176–185).

According to data from the Authority of Audit, Accounting, Property valuation, and Insolvency management under the Ministry of Finance of the Republic of Lithuania, from the entry into force of the Republic of Lithuania's Law on Personal Bankruptcy (hereinafter, the Lithuanian BA) on the 1 March 2013 until the 31 December 2020, bankruptcy cases were initiated against 2,833 natural persons. In Latvia, approximately 13,700 insolvencies of natural persons have commenced[6] since the introduction of these types of proceedings on the 1 January 2008, the vast majority of which came after the entry into force of the current Insolvency Law, Latvijas Vēstnesis, on the 1 November 2010. Meanwhile in Estonia,[7] according to data from the Ministry of Justice of Estonia, 1,055 bankruptcy petitions were submitted against natural persons in 2020 (Ministry of Justice of Estonia, 2021).

[5] Under Article 2(2) of the Republic of Lithuania's Law on Personal Bankruptcy, the definition of insolvency (of a natural person) constitutes a condition where a person is unable to discharge his liabilities as they mature, exceeding the amount of 25 times the minimum monthly wage as approved by the Government of the Republic of Lithuania. Article 1 of the Estonian Bankruptcy Act provides the definition of bankruptcy as constituting the insolvency of a debtor declared by a court ruling. A debtor is insolvent if they are unable to satisfy the claims of creditors, and if such an inability, due to the debtor's financial situation, is not temporary. A debtor who is a legal person is also insolvent if their assets are insufficient for covering their obligations and, due to the debtor's financial situation, such an insufficiency is not temporary. The Latvian Insolvency Law does not provide a definition of the insolvency of a natural person as such, but this term can be ascribed a meaning such that insolvency is a state of a natural person with respect to whom insolvency proceedings have been commenced. Despite differences in the terminology, the terms *insolvency* of a natural person and/or *bankruptcy* of a natural person are used interchangeably (as synonyms) in this article.

[6] i.e., the insolvency application has been satisfied by the court.

[7] In Estonia, regular official statistics on bankruptcy cases are not published. Information can be obtained through inquiries in the court information system or in the official publication *Ametlikud Teadaanded*. Therefore, bankruptcy statistics may differ from source to source.

The data in Table 1 show that, of all three Baltic states during the years of 2015–2020, Latvia had the highest number of insolvency proceedings commenced against natural persons, whereas Lithuania was quite significantly behind the other two countries in this regard. There is no doubt that one of the reasons for these numbers is the date when the law on the bankruptcy proceedings of natural persons came into force, with Lithuania being the last Baltic state to adopt such legislation (Estonia did so in 2004, Latvia in 2008, and Lithuania in 2013).

Table 1.
The number of insolvency proceedings commenced against natural persons in the Baltic states in 2015–2020.

State / The year	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Lithuania (The Authority of Audit of the Republic of Lithuania, 2021)	448	456	473	398	306	264
Estonia[8]	approx. 750	approx. 750	approx. 750	release of debtor from obligations (approx. 700 petitions) and debt restructuring petitions (approx. 50 applications)	release of debtor from obligations (approx. 700 petitions) and debt restructuring petitions (approx. 50 applications)	1,055
Latvia (Lursoft, 2021)	1,632	1,550	1,537	1,281	1,242	1,040

It is important to note that Lithuania differs from the other Baltic states in its public presentation of detailed statistics regarding the number of bankruptcies of natural persons, as it has an official institution which presents data on the bankruptcy proceedings of natural persons. We may also state that the "boom" in the bankruptcy of individuals is fading, but the issue remains relevant – especially during the pandemic period. One of the factors determining the decision of a natural person to seek bankruptcy is the regulation of reasonable grounds (i.e., entry criteria) for initiating bankruptcy proceedings. Therefore, this article further analyses the conditions set forth in the bankruptcy-related legal acts of Lithuania, Latvia, and Estonia that are required for the initiation of the bankruptcy proceedings of natural persons. The main bases (criteria) of the evaluative comparison that seeks to find the Baltic state with the most attractive insolvency regimes are: the definition of the subject; the initiator of insolvency proceedings; and the entry criteria (i.e., grounds) for opening insolvency proceedings. Indeed, the conditions required to open bankruptcy proceedings against a natural person are only one element among others on which the attractiveness of insolvency regimes is based. Therefore, in order to reach a conclusion on the most favourable regime, the authors of this article also amend the evaluation that follows their comparative analysis by considering the criteria of: the cost of such proceedings; the period of discharge; and the dischargeable debts.

[8] For example, during the period of 2015–2018, 2,996 bankruptcy petitions of natural persons were submitted to the court, an average of approximately 750 applications per year. In addition, during the period of 2017–2019, 2,089 petitions for the release of a debtor from obligations (approximately 700 petitions per year) and 150 debt restructuring petitions (approximately 50 applications per year) were processed.

1. The legal regulation in the Republic of Lithuania

Until April 2010, Lithuania did not have an effective modern law on the bankruptcy of natural persons (the Resolution of the Government of the Republic of Lithuania No. 189 on the approval of the measures for the implementation of the program of the Government of the Republic of Lithuania for 2008–2012, 2009), and until May 2012 there was also no national act regulating the legal dimension of the bankruptcy of natural persons. After the Seimas adopted the Lithuanian BA,[9] Lithuania was removed from the list of archaic European Union member states in which the bankruptcy of a natural person is not possible.

1.1. The subject and initiator of insolvency proceedings

The common feature of the subjects of insolvency proceedings of natural persons in Lithuania is the absence of the status of a legal personality. Such persons (subjects under the Lithuanian BA) that can apply for the initiation of bankruptcy proceedings are divided into three groups: natural persons[10]; farmers[11]; and other natural persons pursuing individual activities, acting in good faith, as defined by the Law of the Republic of Lithuania on Personal Income Tax.[12] Thus, it can be stated that a wide range of unincorporated persons are now able to go bankrupt in Lithuania. Under the Lithuanian BA, the subject and the initiator coincide – i.e., personal bankruptcy proceedings may be initiated only by a natural person themselves (Article 1(4) of the Lithuanian BA).

1.2. Entry criteria (grounds) for opening insolvency proceedings

The courts and the legislator of Lithuania have established three main grounds for opening bankruptcy proceedings against a natural person: the natural person must be at least 18 years old; the natural person must be deemed technically insolvent, i.e., unable to fulfil their debt obligations, the payment terms of which have expired and the amount of which exceeds 25 months of minimum wage as approved by the Government of the Republic of Lithuania[13] (hereinafter, the MMW); and the natural person must comply with the criterion of fairness.

Natural persons linked to joint assets and/or joint obligations towards creditors may go bankrupt under a single case in the Republic of Lithuania. Natural persons seeking to file bankruptcy in one case may submit a joint application to the court to open bankruptcy proceedings against them or, before the approval of the satisfaction of creditors' claims and the restoration of the solvency of the natural person (hereinafter, the Lithuanian plan), submit an application to the court to intervene in proceedings initiated by another natural person (Article 41 of the Lithuanian BA).

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[9] The Lithuanian BA was adopted on the 10 May 2012 and came into force on the 1 March 2013.

[10] A natural person is understood as an ordinary consumer – i.e., someone who is not engaged in commercial activities (such as individual activities or farming).

[11] "Farmer" means a natural person who, alone or with partners, engages in agricultural activities and forestry, and whose farm is registered in their name and represented by them in the Register of Farmers' Farms (Law of the Republic of Lithuania on Farmer's Farms, 1999, Art. 2(2)).

[12] Individual activities shall mean any independent activity in pursuit whereof an individual seeks to derive income or any other economic benefit over a continuous period: 1) independent commercial or industrial activities of any nature, except activity for the sale and/or rental of immovable property by nature, as well as transactions in financial instruments; 2) independent creative or professional activities (for example: attorneys-at law, notaries, bailiffs) and other similar independent activities, including those exercised under a business certificate; 3) independent sports activities (activities of an athlete (a resident who performs a certain physical or mental activity, based on certain rules and organized in a certain form specially established for this activity) for competitions and participation in competitions); 4) independent performing activities (performer, actor, singer, musician, conductor, dancer or other resident, singing, reading, reciting or otherwise performing literary, artistic, folklore or circus numbers) preparation for and participation in a public performance (Law of the Republic of Lithuania on Personal Income Tax, 2002, Art. 2).

[13] From the 1 January 2021 the MMW in Lithuania was set at EUR 642 (the Resolution of the Government of the Republic of Lithuania No 1114 due to the MMW applicable in 2021, 2020).

Regarding the aforementioned essential conditions, it must be said that, first of all, the condition of adulthood is rather clear – in Lithuania, a natural person over the age of 18 is considered an adult who has the right to file for bankruptcy.

Second, the essential and mandatory condition of declaring a natural person bankrupt is economic in nature. Article 2(2) of the Lithuanian BA provides the definition of insolvency of a natural person as constituting an inability to fulfil their debt obligations, the payment terms of which are overdue and the amount of which exceeds the respective amount approved by the Government of the Republic of Lithuania. The approach of legislators is confirmed by the case law of Lithuanian courts: "<...> a bona fide natural person shall be considered completely insolvent when the financial condition of the bona fide natural person is critical and they are unable to fulfil debt obligations that have expired ..." (Vilnius Regional Court, 2013). It is emphasized that natural persons may only initiate bankruptcy proceedings if they are actually insolvent and incapable of paying their overdue debts and meeting their debt obligations due to lack of funds. Insolvency indicates the material situation of a natural person (the debtor) when their available assets are insufficient to fully satisfy their creditors' claims, and when the debtor is unable to settle with their creditors. The corollary is that a natural person whose debt obligations have not matured cannot be considered insolvent. This provision presumably seeks to ensure the stability of civil legal relations and prevent any abuse of insolvency proceedings by either creditors or debtors. A qualifying debt amount of 25 MMW was selected to avoid unnecessary insolvency proceedings involving minor amounts. The drafters of the Lithuanian BA chose one of the main social indicators of the state for determining the insolvency of a natural person, by taking into account the practice of a neighbouring country with a similar level of economic development and the economic situation within the state. It should be noted that the established threshold amount has more than doubled over the past 8 years since the entry into force of the Lithuanian BA. On the 1 March 2013, this sum amounted to LTL 25,000 (equivalent to EUR 7,246), whereas on the 1 January 2021 this amount was equal to EUR 16,050. In view of this, said threshold will only continue to increase in the future as a result of Lithuania's increasing MMW (which increases at least once and sometimes several times per year).

It is important that the Lithuanian BA is applied to natural persons, regardless of the period during which their debts arose. That is to say, the insolvency of a natural person is determined by assessing all of their debt obligations, including those assumed before the entry into force of the Lithuanian BA (Article 1(7) of the Lithuanian BA).[14] Determination of insolvency is one of the essential factors in deciding whether to initiate bankruptcy proceedings against a natural person, which is determined via the third condition – the criterion of fairness (*bona fide*) (Vilnius Regional Court, 2013). The aspect of fairness is left to the assessment of the courts, whereby: an analysis of the reasons for the insolvency of a natural person is performed; the circumstances of the occurrence of the debtor's liabilities are examined; and an assessment of their efforts to find paid employment, a better-paying job, or engage in other income-generating activities is conducted. As well as this, the natural person's use of consumer credit, amount of debt obligations, amount of assets held, the prospects of the debtor fulfilling their debt obligations, the natural person's harmful habits, and other similar factors are taken into account. It should be noted that if, for example, a natural person becomes insolvent due to their harmful habits such as abuse of alcohol, drugs or other psychotropic substances, or gambling (a natural person must submit to the court a certificate issued by the Centre for Addictive Disorders), the court, in light of the criterion of fairness, must in all cases establish a causal correlation between the circumstances proving the person's misconduct and their insolvency (Tamošiūnienė, Terebeiza, & Bolzanas, 2013, p. 79). Even if the natural person's financial obligations are greater than their assets, if the income received by that person allows them to fulfil all of their financial obligations within a reasonable period of time, this would mean that the person is able to meet their debt obligations and should not be permitted to use bankruptcy proceedings to avoid liabilities.

[14] In accordance with the decision of the Constitutional Court of the Republic of Lithuania (1998), which emphasizes the fact that the adoption of retroactive legislation is possible if this is specified in the law itself, and if such legislation would not worsen the legal situation for legal entities (*lex benignior retro agit*).

2. The legal regulation in the Republic of Latvia

Insolvency proceedings of a natural person were introduced into Latvian legislation with the adoption of the (previous) Insolvency Law (Latvijas Vēstnesis, 2007) that entered into force on the 1st of January 2008 (hereinafter, the Latvian IL 2008). These proceedings were lengthy, complex, and costly. It can be argued that the regulation of these proceedings was more suited to complex corporate restructuring rather than the fresh start of an ordinary over-indebted consumer. Thus, the law required the debtor to submit an extensive bundle of documents to the court, such as documentary proof of their income during the past 12 months (Article 154 (3) of the Latvian IL 2008). In addition, the debtor had to prepare a plan of sale of their property and the satisfaction of creditors' claims (Article 155 of the Latvian IL 2008) which, if the debtor had assets, proved to be a rather complex exercise. Often, the aforementioned plan had to be amended over the course of the proceedings, and the amendments had to be filed with the court accordingly (Article 164 of the Latvian IL 2008). Both the preparation of the aforementioned plan and its amendments could have incurred substantive legal costs. Moreover, the regulation provided for the extensive work of an insolvency administrator prior to the initiation of the proceedings and during their course (Articles 157 and 159 of the Latvian IL 2008). The debtor had to pay monthly remuneration to the administrator and cover the other costs of insolvency proceedings accordingly (Article 154 (3) of the Latvian IL 2008). If the debtor could not prove that they were able to cover these costs, a fresh start by means of insolvency proceedings was not available to them. The length of insolvency proceedings was rigidly set at seven – later, five – years, irrespective of the circumstances of the particular insolvency proceedings (Article 174 (2) of the Latvian IL 2008).

Unsurprisingly, the Latvian legislator's first attempt at providing an opportunity for a fresh start for over-indebted individuals was unsuccessful. The previous Insolvency Law was in force for slightly less than three years, and was substituted by the current Latvian IL (Latvijas Vēstnesis, 2010) (hereinafter, the Latvian IL 2010) that has been in force since the 1st of November 2010.[15] The regulation of the insolvency proceedings of a natural person in the current Insolvency Law has increased the availability of these proceedings, and substantially increased an over-indebted consumer's chances of successfully discharging their debts – as can be seen from the statistics presented in the introduction to this paper.

2.1. The subject and initiator of insolvency proceedings

A subject of the insolvency proceedings of a natural person may be any natural person who has been a taxpayer in the Republic of Latvia in the previous six months and who is in financial difficulty (Article 127 of the Latvian IL 2010). Only the debtor themselves may file for insolvency (Article 133 (1) of the Latvian IL 2010). Taking into account that the purpose of these proceedings is to provide a fresh start for an individual (while ensuring that their debts are settled from their assets), it is the debtor's right to make themselves available to these proceedings. Hence, the debtor is not obliged to file for insolvency in case of financial difficulty. There is an additional option to submit a joint insolvency application for spouses or persons in relation or affinity to the second degree.

2.2. Entry criteria (grounds) for opening insolvency proceedings

The entry criteria for the insolvency proceedings of a natural person are as follows (Article 129 of the Latvian IL 2010): the debtor does not have the possibility of settling debt obligations for which the due date has passed, and the debt obligations exceed EUR 5,000 in total (i); in connection with provable circumstances, it will not be possible for the debtor to settle debt obligations which will be due within a year, and the debt obligations exceed EUR 10,000 in total (ii); the debtor does not have the possibility of settling debt obligations out of which at least one debt obligation is based on an unsettled ancillary obligation or joint obligation between the debtor and the

[15] Hereinafter, references to the "Insolvency Law" are references to the current Insolvency Law in force.

debtor's spouse, or a person who is in relation or affinity to the debtor to the second degree, the amount of which exceeds EUR 5,000 (iii).

According to the court practice, the court must restrict itself to the formal establishment of the aforementioned entry criteria and must not assess the causes of the debts (Senate of the Supreme Court of the Republic of Latvia, 2013)

There are also negative entry criteria. Thus, the insolvency proceedings of a natural person shall not be applicable or terminable for a person (Article 130 of the Latvian IL 2010): who in the last three years prior to the commencement of insolvency proceedings of a natural person has deliberately provided false information to his or her creditors (i); who has spent the granted loan for purposes other than those stated in the agreement and a ruling of the competent authority has entered into effect in criminal proceedings (ii); who has, within the last 10 years prior to the declaration of insolvency proceedings of a natural person, had insolvency proceedings of a natural person terminated within the scope of which obligations have been discharged (iii); within the last five years prior to the commencement of insolvency proceedings of a natural person or during insolvency proceedings of a natural person, a ruling of the competent authority has entered into effect in criminal proceedings under which it has been established that the debtor has avoided tax payment (iv); who has had insolvency proceedings of a natural person terminated without discharging the obligations within the last year prior to the commencement of insolvency proceedings (v).

3. The legal regulation in the Republic of Estonia

Estonian insolvency law recognises two different types of proceedings for natural persons: debt restructuring and bankruptcy. Debt restructuring proceedings are regulated by the Debt Restructuring and Debt Protection Act (hereinafter, the Estonia DRDPA) (Võlgade ümberkujundamise ja võlakaitse seadus, 2010), and their purpose is to facilitate the restructuring of the debts of a natural person with problems of solvency in order to overcome these problems and avoid bankruptcy. Bankruptcy proceedings, on the other hand, are regulated by the Bankruptcy Act (hereinafter, the Estonian BA) (Pankrotiseadus, 2004), and are conducted if a debtor is insolvent. According to Article 1 (2) of the Estonian BA, a debtor is insolvent if they are unable to satisfy the claim of a creditor that has fallen due and such an inability, due to the debtor's financial situation, is not temporary. According to Article 2 of the Estonian BA, a debtor who is a natural person is also given the opportunity to be released from their obligations through bankruptcy proceedings pursuant to the procedure prescribed in the Estonian BA. The provisions for the proceedings of the release of a debtor who is a natural person from obligations entered into force in 2004 (Chapter 11 of the Estonian BA).

3.1. The subject of insolvency proceedings

Estonian applicable bankruptcy law does not give a definition of who a natural person is and to whom the Estonian BA applies. Only Estonia DRDPA Article 4 (1)–(2) provides the definition that a debtor is subject to debt restructuring proceedings regardless of their status as an enterprise. Debt restructuring may be applied for by a debtor whose place of residence is in Estonia and who has resided in Estonia for a period of no less than two years before submitting the debt restructuring petition.

3.2. Entry criteria (grounds) for opening insolvency proceedings

The Estonian bankruptcy law recognises two different stages of proceedings for natural persons: bankruptcy proceedings, and proceedings for the release of a debtor from obligations which were not addressed during the bankruptcy proceedings. In fact, it could be said that the proceedings for the release of a debtor from obligations are the most important part of the bankruptcy proceedings of a natural person.

A bankruptcy petition may be filed by a debtor or a creditor (Article 9 (1) of the Estonian BA). The creditor shall substantiate the debtor's insolvency and prove the existence of a claim. Also, the total amount of the claims that form the basis for the bankruptcy petition of the creditor must exceed EUR 1,000 in the case of a natural person (except if unsuccessful execution proceedings have been conducted with respect to the abovementioned claims within one year prior to the filing of the bankruptcy petition (Article 10 (1), Article 15 (3)) of the Estonian BA). The debtor, on the other hand, shall submit an explanation concerning the cause of the insolvency and a list of debts (Article 13 (2) of the Estonian BA). In fact, natural persons in Estonia are not obliged to submit bankruptcy petitions in cases of insolvency.

After accepting a bankruptcy petition, the court shall decide on the appointment of an interim trustee or, taking into account the financial situation of the debtor, refuse to appoint an interim trustee and instead declare bankruptcy (Article 15 (2) of the Estonian BA). However, a court shall not declare bankruptcy regardless of the insolvency of the debtor who is a natural person if a basis for refusal to appoint an interim trustee (specified in Article 15 (3) of the Estonian BA) exists. Nevertheless, the court may declare bankruptcy in situations where the debtor or a third party has, before the appointment of an interim trustee, performed the obligation on which the bankruptcy petition is based or provided sufficient security for the performance of the obligation (Article 31 (2) of the Estonian BA).

In a situation where bankruptcy has been declared, there are in general no different procedural acts in the bankruptcy proceedings of natural persons compared to those of legal persons: creditors' claims are defended, bankrupt estates are sold (if there are any), and payments from are made from the bankrupt estates. However, a court may prohibit a debtor who is a natural person from acting as a sole proprietor, a member of the management body of a legal person, the liquidator of a legal person, or a procurator, until the end of the bankruptcy proceedings (Article 91 (1) of the Estonian BA). In fact, it can be argued that the most important procedural act in the first stage (of bankruptcy proceedings) is to determine the creditors' claims.

Moreover, the main difference between the bankruptcy proceedings of legal and natural persons arises after the proceedings are terminated. Whilst a legal person shall be deleted from the commercial register, a debtor who is a natural person may be able to enter the second stage of proceedings. This means that after the termination of bankruptcy proceedings (by approval of the final report (Article 163 of the Estonian BA) or in the event of abatement of the bankruptcy proceedings (Article 158 of the Estonian BA)), the commencement of proceedings for the release of a debtor from obligations may be decided by the court. In fact, this is generally the purpose of the bankruptcy proceedings of natural persons. However, without going through the first stage (the bankruptcy proceedings), it is not possible to enter to the second stage (the proceedings for the release of a debtor from obligations).

In fact, the petition for the release of a debtor from obligations should be provided with the bankruptcy petition. In a situation where a debtor's assets are insufficient for covering the costs of the bankruptcy proceedings and it is impossible to recover or reclaim the assets, the court will declare bankruptcy only if the debtor has submitted a petition for the release of the debtor from obligations. Otherwise, there is no purpose of the bankruptcy proceedings, and the court may terminate the proceedings by abatement without declaring bankruptcy regardless of the insolvency of the debtor.

However, there are currently many amendments planned that concern the insolvency proceedings of natural persons in Estonia. According to the draft law of March 2021, there would be a single act (hereinafter, the Natural Persons' Insolvency Act) for a debtor who is a natural person, which enables them to submit an insolvency petition to the court (Ministry of Justice of Estonia, 2021). The purpose of the proposed amendments is to make the bankruptcy proceedings of a natural person cheaper and quicker, and to simplify the judicial and extra-judicial proceedings under the Estonian BA and Estonian DRDPA. Therefore, a person shall be required to complete a (mandatory) pre-trial debt counselling, where the debtor's economic situation will be determined. In justified cases, an insolvency petition together with a repayment plan shall be prepared for the court. Taking into consideration the circumstances set out in the petition and the concrete situation of the debtor, the court will

provide guidance on whether bankruptcy or debt restructuring proceedings are to be undertaken. As the activity of a sole proprietor is secured by a natural person's assets, one proceeding is conducted in respect of a natural person and sole proprietor. Therefore, based on the insolvency petition, the court decides whether to initiate: (i) bankruptcy proceedings of a natural person; (ii) bankruptcy proceedings and proceedings for the release of a debtor from their obligations; or (iii) debt restructuring proceedings. Bankruptcy proceedings, however, are conducted in accordance with the provisions of the Estonian BA. In previous cases, the creditor has also had the opportunity to file an insolvency petition (Ministry of Justice of Estonia, 2021). However, according to the applicable law, the creditor cannot submit a debt restructuring petition (Article 10 of Estonia DRDPA).

In fact, the law will apply to all natural persons, irrespective of whether the debtor is an enterprise. However, debt restructuring proceedings cannot be initiated against a debtor whose place of residence is in Estonia and who has resided in Estonia for a period of no less than one year before submitting the petition. A two-year period (as in applicable law) was found to be too long (Ministry of Justice of Estonia, 2021).

In addition, legal proceedings will be reduced in duration, and procedural deadlines shortened. According to the proposed amendments, the proceedings for the release of a debtor from obligations, conducted during bankruptcy proceedings, will be reduced from a duration of five years to a maximum of three (Ministry of Justice of Estonia, 2021). Taking into account that the debtor submits the insolvency petition with a repayment plan, then the court will be able to approve the repayment plan earlier and therefore the release of the debtor from obligations is also initiated earlier. However, the term may be extended by up to one year in case of dishonest debtors. In order to exclude potential abuse by the debtor, the court may annul the ruling on the release of the debtor from obligations.

Moreover, in case of abating proceedings under the Estonian BA, the court will have the right to decide on the commencement of proceedings for the release of a debtor from obligations without bankruptcy proceedings (the so-called first stage). Additionally, several minor amendments are envisaged for the more efficient and faster conduct of proceedings (such as the sale of pledged property through a bailiff, a positive credit information register, the termination of enforcement proceedings, a prohibition on business and entrepreneurship, and an official bank account).

4. A comparative analysis of the legislation of the Baltic states

4.1. Legal regulation on subject of insolvency proceedings

Following the adoption of the EU regulation on insolvency proceedings by the EU Council (Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings (OJ L 160) which was changed by the Recast Regulation EU (2015/848) of the European Parliament and of the Council, dated 20 May 2015, on insolvency proceedings), the Baltic states established the concept of personal bankruptcy in their national laws at different times: Estonia in 2004; Latvia in 2008; and Lithuania in 2013. Although it was one of the last countries in the EU to adopt its own legislation in this regard (the Lithuanian BA), the conditions for bankruptcy in Lithuania are relatively complicated. Consolidation of the conditions for the bankruptcy of natural persons reaffirms the notion that the Lithuanian BA regulates only the bankruptcy process of natural persons who comply with the principle of fairness – i.e., insolvency cannot be the result of abuse or criminal activity. When comparing the grounds established in the laws of the aforementioned countries under which bankruptcy proceedings would not be opened against a natural person, one can conclude that Lithuania is the only country where a person cannot initiate bankruptcy proceedings if their insolvency results from their harmful habits. The establishment of this condition expresses the legislator's concern and their strict attitude towards the irresponsible behaviour of natural persons. The weakness of such a requirement is that the extent of the irresponsibility required to disallow bankruptcy is subjective, especially as we have to assume that those completely without sin are a very small minority of the population. The result of this is that the application of such a term lacks the certainty and predictability tests of a good law.

With respect to Latvia, there is a criterion that the applicant must be unable to settle their debt obligations – i.e., that they lack the ability but not the will to settle debt obligations. In essence, a similar principle is applied in Estonian bankruptcy proceedings – the bankruptcy petition can be submitted to the court in situations where the debtor is permanently unable to satisfy the creditors' claims which have fallen due. However, if a debtor's assets are insufficient to cover the cost of the bankruptcy proceedings and the debtor has only obligations from which release is impossible by law (such as the obligation to compensate for damage intentionally caused by unlawful action, or the obligation to pay for the support of a child or parent), then the court may refuse to initiate bankruptcy proceedings. In this case, there would be no purpose for bankruptcy proceedings, because the release of the debtor from these obligations is impossible.

It should also be emphasized that the initiators of the Lithuanian BA did not incorporate provisions on the bankruptcy of natural persons into the pre-existing legal regulation on the bankruptcy proceedings of legal entities in the country (as in the case of Latvia – the Latvian IL 2008 and/or Latvian IL 2010 (Latvijas Vēstnesis, 2007; Latvijas Vēstnesis, 2010) and Estonia – the Estonian BA (Pankrotiseadus, 2004)), instead adopting a separate special law exclusively regulating the bankruptcy proceedings of natural persons. The adoption of a unified legal act regulating the legal relations of bankruptcy (insolvency) is to be welcomed, as this would help achieve a smoother, more rational, more economical, faster, and more efficient implementation of provisions. It is important to stress that, by considering the application of different concepts, different laws have been adopted in neighbouring countries to regulate the bankruptcy proceedings of natural persons. For example, an insolvency law has been adopted in Latvia, while bankruptcy laws have been adopted in Lithuania and Estonia. Although the terms "insolvency" and "bankruptcy" are often used interchangeably in legal literature, in truth they have different meanings. The term "insolvency" describes the financial situation of a natural person when they are unable to pay their creditors due to their poor financial situation. Bankruptcy, on the other hand, is a legal process that provides one way to solve the insolvency problems of a natural person, consisting of "economic liquidation" (restoration of solvency) procedures and debt reconciliation with creditors. Consequently, the main difference between the concepts of bankruptcy and insolvency is that "bankruptcy" is an official legal term that explains how to resolve the insolvency of a natural person and lays down procedures for sharing insufficient assets equitably among creditors. Once this has taken place, some semblance of a "fresh start" permits the restoration of the solvency of the debtor. The aspiration to consider the insolvency of a natural person in a broader sense by providing further solutions to this problem (for example, by providing the opportunity for an agreement between the debtor and the creditors before the commencement of bankruptcy proceedings), as well as taking into account the aim and concept of insolvency, determines the need to follow the example of Latvia and change the current title of the law to a more relevant one that is more commonly used in foreign countries and would summarize the insolvency of a natural person (the draft of Natural Persons' Insolvency Act of the Republic of Estonia, 2021).

The fact that a relatively wide range of natural persons have the opportunity to take advantage of the possibility of bankruptcy in the Baltic states without dividing them as entities (Mikuckienė, 2003) into entrepreneurs (natural persons engaging in certain economic/commercial activities) and consumers (natural persons participating in civil turnover) characterized by a common element – lack of legal entity rights – is received positively, and unifies different countries (Lithuanian BA, Article 1(1); Estonian BA, Article 2; Latvian IL 2010, Article 1 (2)). In Latvia, one exception is that a natural person who is registered with the Commercial Register of Latvia as an individual merchant (*individuālais komersants*) or who is a general partner in a partnership or a member in a farm or a fishery must undergo insolvency proceedings of a legal person, first, in order to become eligible to apply for insolvency proceedings of a natural person (Latvian IL 2010, Article 123).

4.2. Legal regulation on the entry criteria (grounds)

One important condition is that, according to both Lithuanian and Latvian laws, insolvency (bankruptcy) proceedings may be instituted against a natural person only if the amount of the creditor's claim is higher than the minimum threshold amount of debt established by law. The position of the Lithuanian legislator in linking the threshold of debt (starting point) with one of the main social indicators and evaluation criteria of the state – the

MMW of the Republic of Lithuania – was welcomed, as personal consumption habits and debt obligations change with the increasing development and economic capacity of the state. The following criteria must be assessed and applied to verify insolvency in Lithuania: 1) the amount of debt obligations must exceed 25 MMW; 2) these debts must be overdue; and 3) the person must no longer be (objectively) able to cover these debts with their assets (the balance sheet test) or income (the cashflow test).

The following criteria must be established in order to commence insolvency proceedings in Latvia: (i) the person must have been a taxpayer in the Republic of Latvia in the previous six months; (ii) the person must be in financial difficulties; (iii) the amount of overdue debt obligations (debts) must exceed EUR 5,000 (including under an unsettled ancillary obligation or joint obligation between the person and the person's spouse or a person who is in relation or affinity to the second degree, if it exceeds EUR 5,000) or, in connection with provable circumstances, it must not be possible for the person to settle debt obligations which will be due within a year, and these debt obligations exceed EUR 10,000; and (iv) the person must no longer be (objectively) able to cover these debts with their assets or income.

In Estonia, the most important criterion is that the insolvency of the debtor is substantiated in the bankruptcy petition, regardless of whether the bankruptcy petition has been submitted by the debtor or the creditor. However, the burden of obligation for substantiation of the bankruptcy petition depends on whether it has been submitted by a debtor or a creditor. There are several circumstances prescribed in the law for the creditor to substantiate the bankruptcy petition (Article 10 (1) of the Estonian BA), while in the case of the debtor's bankruptcy petition, it is sufficient that the debtor provides an explanation concerning the cause of the insolvency and a list of debts (Article 13 (2) of the Estonian BA). In addition, the specific amount of the creditors' claim(s) is only important in the case of the bankruptcy petition of the creditor – the total amount of the claims which are the basis of the bankruptcy petition shall be higher than the minimum amount established by law (EUR 1,000; except in cases of unsuccessful execution proceedings within one year prior to the filing of the bankruptcy petition; Article 15 (3) p 3 of the Estonian BA). In essence, in case of a debtor's bankruptcy petition, the total amount of the creditors' claims is irrelevant.

When a natural person's financial obligations are greater than their assets but the income received by that person allows them to fulfil all of their financial obligations within a reasonable period of time, that person is still able to meet their debt obligations. The mere fact that a person's debts exceed the value of their assets does not mean that that person is insolvent if they receive an income that is sufficient to cover the debts falling due for payment. Conversely, the fact that a person receives a large income does not automatically imply their solvency if the income received is still insufficient to cover their obligations as they fall due. To ascertain whether or not a person is able to meet their obligations, it is necessary to determine and assess the person's amounts payable, income received, actual amounts received, and the funds necessary for subsistence during the reporting period (month). Determination of insolvency is one of the essential factors in deciding whether to initiate bankruptcy proceedings against a natural person, which is determined via the criterion of fairness.

The integrity of the debtor as a core value and principle in the initiation of personal bankruptcy proceedings is important in all of the Baltic States. However, it is most clearly defined in Article 6 of the Latvian IL 2010, which states that a debtor may not use bankruptcy proceedings to earn a living unfairly (Article 6 of the Latvian IL 2010). In Lithuania and in Estonia, problematic aspects related to the determination of the criterion of fairness are left to the discretion of the courts. To this end: an analysis of the causes of insolvency of a natural person is performed; signs of exploitation and/or criminal activity are ascertained; the circumstances of the occurrence of debts are examined, including the efforts of the natural person to find a job or engage in other income-generating activities; and the person's efforts to find a better paying job, the person's use of consumer credit, and the amount of debt obligations are assessed, including the weight of assets held, possible prospects for the debtor to fulfil their debt obligations, the debtor's harmful habits, etc. By considering the provisions of the Lithuanian BA, the integrity of the debtor is assessed both before the commencement of (to determine whether the natural person has become

insolvent by acting honestly, and is therefore qualified to enter bankruptcy proceedings) and during bankruptcy proceedings (to determine the integrity of the natural person in the performance of relevant obligations arising from the bankruptcy laws after the commencement of the bankruptcy proceedings (Ambrasaitė & Norkus, 2014, p. 180), and as such whether the person is therefore qualified to exit bankruptcy proceedings with "a fresh start"). In fact, in Estonia, the criterion of the fairness of the debtor is more evident in the termination of bankruptcy proceedings and during the proceedings of release of a debtor from obligations. A debtor who has wrongfully violated the interests of creditors may not have the opportunity of release from obligations and thus a "fresh start". At the same time, in Latvia, there are specific negative criteria that preclude a debtor from accessing insolvency proceedings set forth in the law (such as the deliberate provision of false information to creditors in the three years prior to the commencement of insolvency proceedings), and until now the courts have not usually assessed the integrity of the debtor as a precondition for the commencement of insolvency proceedings, except in assessing whether the debtor is objectively unable or is merely unwilling to settle their debt obligations.

The exclusion of such aspects is justified as they help courts to determine whether the debtor acted in good faith or not during the bankruptcy proceedings. It should be noted, however, that there must be a causal link between a person's dishonest conduct and their insolvency – the person's dishonesty must have had a direct or indirect impact on their insolvency. This means that transactions that do not directly or indirectly affect solvency and the other conduct of the applicant must not prevent them from going bankrupt. When assessing the integrity of a person in terms of the Lithuanian BA (Article 5(8) of the Lithuanian BA), a strictly set period of three years must be followed. No actions taken by the debtor outside of this period can be assessed in terms of integrity, regardless of whether they were the cause of their insolvency. The Latvian IL 2010 prescribes that the deliberate provision of false information to creditors in the three years prior to the commencement of insolvency proceedings is a condition precluding the commencement of insolvency proceedings (Article 130 of the Latvian IL 2010). At the same time, a wider debate might be required as to whether to allow dishonest debtors who have not committed serious violations from accessing insolvency proceedings and discharging their obligations by means of these proceedings, but under special/less favourable conditions (e.g., applying longer discharge periods) than for honest debtors (The Insolvency Control Service and Law firm Novius, 2018).

In Estonia, for example, the court refuses to release a debtor from obligations if they have violated the obligation to provide important information (i.e., regarding changes in residence or place of establishment, or income or assets received) and have thereby damaged the interests of the creditors.

4.3. Legal regulation on initiators and those who have the right to initiate insolvency proceedings

The fact that, unlike in Estonia, in Lithuania and Latvia only the debtor themselves has the right to initiate bankruptcy proceedings, and creditors have no right to do so, is viewed critically. It has been pointed out that vesting creditors with the right to initiate insolvency proceedings against individual debtors could have a positive effect on the payment discipline of said debtors, and on promoting proactive action in addressing financial difficulties from their side. At the same time, care should be exercised when implementing this option, as it also has some obvious negative features which should be properly mitigated in the regulation (Sallam, 2015).

4.4. Legal regulation on the cost of insolvency proceedings

Pursuant to Item 8 of Paragraph 1 of Article 83 of the Civil Procedure Code of the Republic of Lithuania (2002), a natural person who has been the subject of bankruptcy proceedings and other persons participating in these proceedings shall be exempt from the payment of stamp duty for appeals and appeals in cassation filed in this bankruptcy case.

Another issue of note is that Estonian, Lithuanian, and Latvian debtors have no legal obligation to file when they know that they are insolvent. In this context, it is appropriate to mention the provision laid down in Article 129 of the Latvian IL 2010, which establishes that the payment of the deposit for an insolvency proceeding into a special

account, in order to cover remuneration for the work performed by the administrator and the expenses of insolvency proceedings before the commencement of bankruptcy proceedings, is a prerequisite for instituting insolvency proceedings. Payment of an appropriate amount as one of the prerequisites for initiating bankruptcy proceedings is to be regarded as a means of preventing the debtor from exploiting the institute for debt relief. Therefore, the aim is to follow the tendency in Lithuania, where favourable conditions are created for honest debtors (until they are found to be dishonest) to apply for the initiation and conclusion of bankruptcy proceedings, in terms of being released from paying their remaining debts to creditors, even if they do not have the funds to cover their court costs. However, the necessity of paying the deposit has been mentioned as an obstacle for accessing insolvency proceedings in Latvia, especially for particularly vulnerable categories of debtors such as disabled persons. With respect to this, the introduction of schemes aimed at alleviating this precondition has been proposed in the doctrine (e.g., payment in instalments, or full or partial relief from the payment) (The Insolvency Control Service and Law firm Novius, 2018).

4.5. Legal regulation on the period of discharge and dischargeable debts

The period of implementation of the Lithuania plan is 3 years (Article 5(7) of the Lithuanian BA). The unsatisfied claims of creditors, including those secured by pledge and/or mortgage, that remain in the Lithuanian plan upon the closing of the personal bankruptcy process (except for cases when a bankruptcy administrator (IP) submits to the court documents evidencing that a natural person is able and will be able to discharge their liabilities in the future) shall be written off. There are three exceptions to this rule: claims for child support for the maintenance of a child/adopted child; claims arising from the natural person's obligation to pay penalties to the state imposed for administrative offences or criminal acts committed by the natural person; and claims of creditors secured by a pledge and/or mortgage, if these creditors and the natural person have agreed on the preservation of the pledged property during the bankruptcy proceedings of the natural person, unless otherwise agreed in the agreement on the preservation of mortgaged property during the bankruptcy proceedings of the natural person (The Estonian Supreme Court, 2013).

In Estonia, the objective of the release of a debtor from their obligations is to enable a new economic start for them in a particularly difficult financial situation when they have tried their best to satisfy the claims of creditors (The Estonian Supreme Court, 2016). Thus, the release of a debtor from obligations should ultimately give them a fresh economic start, and a new chance for a normal economic and social life (The Estonian Supreme Court, 2013). In order to obtain a fresh start, a debtor is required to engage in reasonably profitable activity or to seek such activity if they do not have it. They are also required not to conceal income or assets received, and shall provide information at the request of the court or the trusted representative concerning their activities or search for activity, and concerning their income and assets.

However, the possibility of release from obligations is not every debtor's right (The Estonian Supreme Court, 2016). This means that, firstly, the court has the discretion to decide whether or not to initiate proceedings for release from obligations (The Estonian Supreme Court, 2017). If the debtor has not wrongfully violated the interests of creditors, the court has to initiate the proceedings of the release of the debtor from obligations (The Estonian Supreme Court, 2013; The Supreme Estonian Court, 2011; The Estonian Supreme Court, 2013). Secondly, five years[16] (generally) after the commencement of the proceedings for the release of the debtor from obligations, the court has the discretion to decide whether or not to refuse to release the debtor from their obligations. The court refuses to release the debtor from obligations if they have been convicted of a bankruptcy offence or have wrongfully violated their obligations in the proceedings (specified in Article 173 of the Estonian BA) and thereby damaged the interests of the creditors. This also occurs in cases where the debtor does not submit

[16] Taking into account the circumstances, the court may release a debtor from obligations before five years, but not before three years have passed from the commencement of the proceedings (Article 175 (1^1) of the Estonian BA), or extend the proceedings, but the term in total cannot not exceed seven years from the commencement of the proceedings (Article 175 (5^19 of the Estonian BA).

information concerning the performance of their obligations to the court under oath, or fails to submit information within the term granted by the court. In fact, these are the absolute bases on which the release of a debtor from obligations is not granted (The Estonian Supreme Court, 2016; The Estonian Supreme Court, 2016). In addition, the release of a debtor from obligations which were not performed during the bankruptcy proceedings shall not terminate obligations to compensate for damage intentionally caused by unlawful action or obligations to pay support for a child or parent (Article 176 (2) of the Estonian BA).

The Latvian IL 2010 prescribes certain categories of debts that cannot be discharged by means of the insolvency proceedings of a natural person (e.g., debts for penalties applied in administrative offence proceedings). In such cases, the court cannot commence insolvency proceedings with respect to a person who does not have a viable prospect of discharging debts (Article 129 (2) of the Latvian IL 2010). Prior to filing for insolvency, the debtor must pay a deposit in the amount of two months of the minimum wage (EUR 1,000), and a state duty in the amount of EUR 70 (Article 34 (1) 3) of the Civil Procedure Law).

There is a general consensus that it would be premature to identify a single approach (or "best practice") for the legal treatment of the insolvency of natural persons not engaged in business activities. The insolvency of natural persons is intertwined with social, political, and cultural issues that present too many differences to be treated uniformly. It would be difficult for a homogeneous approach to emerge out of this effort. Policymakers should be aware of the social, legal, and economic peculiarities that may affect the functioning of a regime for the insolvency of natural persons (World Bank Report on the Treatment of the Insolvency of Natural Persons, 2012).

Conclusions

1. Compared to Lithuania, its neighbouring countries established the institute of bankruptcy of natural persons in their national laws much earlier (Estonia in 2004, Latvia in 2008, and Lithuania in 2013). Nevertheless, in all Baltic states the institute of bankruptcy of natural persons emphasises the good faith of the debtor and the "earned fresh start". Pursuant to the bankruptcy laws of all three countries, in case of the successful outcome of the insolvency proceedings, the debtor is released from the obligations (with some exemptions) which were not performed during the bankruptcy proceedings.

2. Both in Lithuania and Latvia there is a downward trend in the number of bankruptcy proceedings initiated against natural persons, while in Estonia the number has been growing in the period from 2015–2020.

3. There is no single answer as to the question of which Baltic state has the best conditions for a natural person to go bankrupt, instead the debtor/natural person needs to make their own decision based on whether they meet the legal requirements. Restoring the solvency of a natural person with the help of a bankruptcy institute must be an exceptional measure, and not a universally encouraged or desirable one. Ensuring the well-being of the society and the state requires the promotion of stable legal relations based on integrity, justice, morality, and other principles. Bankruptcy must not be artificially encouraged in order to make it available to as many people as possible. It is not always necessary to declare the bankruptcy of a natural person, as the primary objective should be the avoidance of bankruptcy. Therefore, there is a need to increase the impact of pre-trial debt counselling, where the debtor's economic situation shall be determined. However, if bankruptcy cannot be avoided, bankruptcy proceedings must be cheap, short, and simple, to provide an "earned fresh start" to the debtor. According to the proposed amendments, Estonia may be on the correct path towards achieving all of these goals, having more efficient insolvency (including bankruptcy) law for natural persons, and being able to proclaim itself the most attractive Baltic state in which to go bankrupt.

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